

Message Text

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PA-01 PRS-01 AID-05 CEA-01 CIAE-00 COME-00 EB-07

EA-07 FRB-03 INR-07 IO-10 NEA-10 NSAE-00 OPIC-03

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PASS TREASURY FOR WIDMAN

E. O. 11652: N/A

TAGS: EFIN, OECD

SUBJECT: WORKING PARTY 3 PAPER ON FUTURE PATTERN OF
CURRENT BALANCES

REF: (A) CPE/WP3/A(75)4

(B) CPE/WP3(75)12

(C) CPE(75)9

1. ALL DOCUMENTS FOR WP-3 AGENDA (REF A) HAVE NOW BEEN
ISSUED. REFDOK B ON FUTURE EVOLUTION OF CURRENT BALANCES
WILL BE HANDCARRIED BY CHARLES SCHOTTA (TREASURY)
TRAVELING OCTOBER 31. REFDOK C WILL BE CARRIED BY
RICHARD SMITH (STATE) TRAVELING OCTOBER 31.
FOLLOWING SUMMARIZES REFDOK B.

2. PAPER EXAMINES HOW OECD COUNTRIES' CURRENT BALANCES
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MIGHT BE AFFECTED OVER NEXT TWO OR THREE YEARS OF

ECONOMIC RECOVERY BY VARIOUS FACTORS SUCH AS DIFFERENTIAL GROWTH RATES, COMMODITY PRICES, THE VOLUME AND PRICE OF OIL IMPORTS, ETC. CONCLUSION IS THAT WHILE PRESENT IMBALANCES SHOULD BE SUBSTANTIALLY REDUCED' THEY ARE UNLIKELY TO BE ELIMINATED OR REVERSED. VARIOUS RELATED POLICY ISSUES, INCLUDING EXCHANGE RATE POLICIES AND THE RELATIONSHIP BETWEEN SOME OF THE ABOVE FACTORS AND THE QUESTION OF BALANCE OF PAYMENTS AIMS, ARE ALSO DISCUSSED.

3. THE TERMINAL POINT IN THE EXERCISE IS DESCRIBED NOMINALLY AS "MID-1978", BUT GIVEN THE CONSIDERABLE UNCERTAINTIES SURROUNDING THE STRENGTH OF ECONOMIC RECOVERY OVER THE NEXT TWELVE MONTHS, THE ACTUAL TIME TAKEN TO REACH THIS POINT SHOULD BE INTERPRETED FLEXIBLY.

4. IT IS ASSUMED THAT AVERAGE RATES OF GROWTH UP TO "MID-1978" WILL BE SUCH AS TO LEAVE OUTPUT SUBSTANTIALLY BELOW AN EXTRAPOLATION OF "POTENTIAL OUTPUT" BASED ON TRENDS PRIOR TO THE OIL CRISIS AND THE RECESSION. TWO SCENARIOS ARE CONSIDERED WITH "RECOVERY" GROWTH RATES OF OECD GNP OF 5-1/2 PERCENT AND 7 PERCENT A YEAR RESPECTIVELY. WITHIN THE TOTAL, FASTER GROWTH RATES ARE GENERALLY ASSUMED FOR COUNTRIES WHERE THE RECESSION HAS BEEN MOST SEVERE, AND VICE VERSA.

5. SECRETARIAT STATES THAT THERE IS NO NEED TO EMPHASISE THE EXTREMELY TENTATIVE NATURE OF THESE QUANTITATIVE FINDINGS IN VIEW OF ALL THE UNCERTAINTIES AND TECHNICAL DIFFICULTIES INVOLVED IN THIS KIND OF ANALYSIS. IT IS HOPED THAT THEY WILL BE ACCEPTED IN THE SPIRIT IN WHICH THEY ARE OFFERED, NAMELY AS A FRAMEWORK DESIGNED TO HELP THE WORKING PARTY IDENTIFY AND ELUCIDATE POLICY ISSUES WHICH MAY ARISE IN THE ADJUSTMENT PROCESS OVER THE MEDIUM RUN.

6. THE MAIN FINDINGS CAN BE SUMMARISED AS FOLLOWS:

(I) DEMAND EFFECTS. THE RECOVERY SHOULD HAVE A SUBSTANTIAL ADVERSE IMPACT ON COMBINED OECD CURRENT ACCOUNT. SINCE ALL COUNTRIES SHARE IN THE RECOVERY, THE LIMITED OFFICIAL USE

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IMPACT ON THEIR RELATIVE POSITIONS IS MITIGATED. NEVERTHELESS, THE ADVERSE IMPACT ON THE UNITED STATES COULD BE OF THE ORDER OF \$7 TO \$11 BILLION, WHILE THE GAIN TO THE GROUP OF SMALLER OECD COUNTRIES CURRENTLY RUNNING A LARGE COMBINED DEFICIT COULD BE OF THE ORDER OF \$1 TO \$4 BILLION. THIS LATTER GROUP MIGHT ALSO GAIN SOMETHING AROUND \$3 BILLION ON INVISIBLES (TOURISM, WORKERS' REMITTANCES).

(II) COMMODITY PRICES. IN A PERIOD OF SUSTAINED EXPANSION, COMMODITY PRICES ARE LIKELY TO RISE FASTER THAN PRICES OF MANUFACTURES, BUT BY HOW MUCH IS A VERY OPEN QUESTION. A STRONG COMMODITY PRICE BOOM WOULD SIGNIFICANTLY STRENGTHEN THE POSITIONS OF THE UNITED STATES AND CANADA (AND A NUMBER OF SMALLER COUNTRIES) RELATIVE, PARTICULARLY, TO JAPAN, BUT ALSO TO MOST EUROPEAN COUNTRIES.

(III) TRADE WITH OPEC. ASSUMING AN UNCHANGED REAL OIL

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PRICE, THE OECD TRADE DEFICIT WITH OPEC SHOULD DECLINE SIGNIFICANTLY DESPITE RISING OIL IMPORTS. BUT THE RELATIVE POSITION OF JAPAN AND, TO A LESSER EXTENT, THE UNITED STATES, MIGHT SUFFER BECAUSE THEIR SHARE IN OECD

OIL IMPORTS IS HIGHER THAN THEIR SHARE IN OECD EXPORTS TO OPEC.

7. TAKEN TOGETHER, THESE FACTORS WOULD SIGNIFICANTLY REDUCE BOTH SURPLUSES AND DEFICITS. DESPITE THIS, HOWEVER, THE UNITED STATES, GERMANY, BENELUX AND SWITZERLAND WOULD STILL BE IN SURPLUS, AND THE UNITED KINGDOM, ITALY, FRANCE AND "OTHER OECD" WOULD STILL BE IN DEFICIT IN "MID-1978". A COROLLARY TO THESE FINDINGS IS THAT THE CUMULATIVE DEFICITS AND SURPLUSES FROM 1974 TO "MID-1978" WOULD BE CONSIDERABLE: FOR EXAMPLE, CUMULATIVE DEFICITS EQUIVALENT TO AROUND 12 PERCENT OF GNP FOR 'OTHER OECD', 10 PERCENT FOR CANADA, LIMITED OFFICIAL USE

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6 PERCENT FOR THE UNITED KINGDOM AND 4 PERCENT FOR ITALY, AND CUMULATIVE SURPLUSES OF AROUND 4 PERCENT OF GNP FOR GERMANY AND OF 5 TO 10 PERCENT FOR BENELUX AND SWITZERLAND.

8. THE ANALYSIS GIVEN HERE SUGGESTS THAT THE UNITED STATES MAY BE ONE OF THE COUNTRIES WITH A REASONABLY STRONG CURRENT BALANCE POSITION IN "MID-1978"; IT IS ALSO A COUNTRY WHERE IT SEEMS REASONABLE TO EXPECT A BETTER-THAN-AVERAGE INFLATION PERFORMANCE. SINCE THE EXTERNAL SECTOR OF THE UNITED STATES ECONOMY IS RELATIVELY SMALL, HOWEVER, THE ARGUMENT THAT CONSEQUENT CURRENCY APPRECIATION COULD, THROUGH ITS CONTRIBUTION TO REDUCING INFLATION, LEAD TO A VIRTUOUS CIRCLE IS NOT VERY CONVINCING. MORE IMPORTANT WOULD SEEM TO BE THE FACT THAT TO A FAR GREATER EXTENT THAN FOR OTHER COUNTRIES THE UNITED STATES' BALANCE OF PAYMENTS (PRE-FLOATING) AND/OR EXCHANGE RATE (POST-FLOATING) HAS TENDED TO REFLECT CAPITAL MOVEMENTS AND RELATIVE MONETARY CONDITIONS RATHER THAN CHANGES IN THE CURRENT BALANCE. THIS RAISES THE QUESTION OF HOW FAR, IN THE CASE OF THE UNITED STATES, THE CURRENT ACCOUNT MIGHT MOVE ON TO A STRENGTHENING (OR WEAKENING) TREND OVER THE MEDIUM RUN WITHOUT PROVOKING A SELF-CORRECTING MOVEMENT IN THE EXCHANGE RATE. AS FAR AS THE UNITED STATES AUTHORITIES ARE CONCERNED, THIS MIGHT NOT BE A MATTER OF CONCERN SINCE THEY HAVE NO SPECIFIC AIMS WITH REGARD TO THE STRUCTURE OF THEIR BALANCE OF PAYMENTS. BUT IT SEEMS LIKELY THAT ANY SIGNIFICANT STRENGTHENING OF THE UNITED STATES' CURRENT BALANCE OVER THE NEXT FEW YEARS COMPARED WITH THE POSITION SUGGESTED HERE FOR "MID-1978" WOULD BE INCOMPATIBLE WITH THE AIMS OF OTHER COUNTRIES AND MIGHT LEAD TO ACTIONS BY THEM WHICH WOULD NOT BE IN THE COMMON INTEREST.

9. IN THE ANALYSIS NO ALLOWANCES ARE MADE FOR EXCHANGE RATE CHANGES OR DIFFERENTIAL RATES OF INFLATION. AN UNCOMFORTABLE FEATURE OF THE FINDINGS IS THAT IN SEVERAL CASES THE COUNTRIES WHICH IT IS SUGGESTED MIGHT FIND THEMSELVES IN A WEAK OVERALL BALANCE OF PAYMENTS POSITION ARE ALSO COUNTRIES WHICH MIGHT BE LIMITED OFFICIAL USE

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EXPECTED TO HAVE ABOVE-AVERAGE INFLATION RATES, AND VICE VERSA. IF THIS WERE TO PROVE CORRECT, IT WOULD SUGGEST THAT DOWNWARD AND UPWARD PRESSURES ON EXCHANGE RATES DURING THE RECOVERY PERIOD RESULTING FROM FACTORS DISCUSSED ABOVE WOULD PROBABLY BE MAGNIFIED BY THE NEED FOR EXCHANGE RATES TO REFLECT DIFFERENCES BETWEEN COUNTRIES IN THEIR INFLATION RATES.

10. IN CONSIDERING THIS QUESTION, IT IS RELEVANT THAT THE DOLLAR IS AT PRESENT NEAR THE TOP OF THE RANGE IN WHICH IT HAS FLUCTUATED OVER THE LAST THREE YEARS AND THAT FOR CYCLICAL AND MONETARY REASONS IT MIGHT STRENGTHEN FURTHER OVER THE NEXT 6-12 MONTHS (CPE/WP3 (75)11. ON THE OTHER HAND, SOME DATA DISCUSSED SHOWS THAT AT CURRENT EXCHANGE RATES DOMESTIC COSTS AND PRICES IN THE UNITED STATES HAVE RISEN OVER THE LAST FIVE YEARS SIGNIFICANTLY LESS FAST THAN IN ALL OF ITS MAJOR COMPETITORS.

11. THERE IS A SECOND QUESTION THE WORKING PARTY MAY WISH TO CONSIDER IN THIS CONTEXT. IT HAS BEEN SUGGESTED THAT EVEN IF IT IS ASSUMED THAT THE "EQUILIBRIUM" RATE FOR THE DOLLAR LIES SOMEWHERE WITHIN THE RANGE OVER WHICH IT HAS BEEN FLUCTUATING (OR SIMPLY THAT THIS QUESTION IS UNANSWERABLE), THE MAGNITUDE OF THESE APPARENTLY LARGELY CYCLICAL FLUCTUATIONS HAS BEEN SUCH

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THAT THEY COULD, IN TIME, HAVE A SIGNIFICANT ADVERSE EFFECT ON TRADE BETWEEN THE GRADUALLY EMERGING DOLLAR AND NON-DOLLAR CURRENCY BLOCS. DO ANY MEMBERS OF THE WORKING PARTY SHARE THIS VIEW?

12. WITH RESPECT TO FINDINGS IN PARA 6 ABOVE, SECRETARIAT ASSUMES THAT THE OECD TRADE BALANCE IN REAL TERMS WITH THE NON-OIL DEVELOPING COUNTRIES MAY DETERIORATE BY \$11-12 BILLION OVER THE PERIOD OF RECOVERY; THIS IS ASSUMED TO TAKE PLACE IN 1976, REFLECTING THE CUT BACK IN IMPORTS OF THESE COUNTRIES NECESSARY TO BRING THEIR CURRENT DEFICIT IN LINE WITH THEIR FINANCING POSSIBILITIES. BY THE END OF 1976, THEIR CURRENT DEFICIT MAY BROADLY HAVE BEEN BROUGHT DOWN TO A SUSTAINABLE LEVEL(1). AFTER 1976, TAKING INTO ACCOUNT LIKELY TERMS OF TRADE GAINS, (BELOW), WIDENING OF THEIR DEFICIT ON SERVICES AND PRIVATE LIMITED OFFICIAL USE

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TRANSFERS, POSSIBLE INCREASES IN OFFICIAL TRANSFERS AND OTHER AID AND NON-AID CAPITAL FLOWS, AND ALLOWING FOR THE FACT THAT THE RUN-DOWN BY RESERVES AND OFFICIAL FINANCING MAY BE REDUCED, IT APPEARS THAT BROADLY THERE MAY BE NO FURTHER CHANGE IN THEIR REAL TRADE BALANCE WITH THE OECD FROM END-1976 TO "MID-1978".

(1) IN FACT, A SLIGHTLY SMALLER CUT-BACK OF DEFICIT IS

ASSUMED IN THE "CAUTIOUS RECOVERY" CASE BECAUSE EVEN WITH
THAT ADJUSTMENT, THE GROWTH OF THEIR IMPORTS WILL BE
LOWER THAN IN THE "STRONG RECOVERY" CASE

13. THE FOLLOWING DATA FOR THE US IS EXTRACTED FROM
TABLE 1 REF B ON HYPOTHETICAL CHANGES IN THE PATTERN
OF CURRENT BALANCES 1975 TO "MID-1978":

(GNP REAL GROWTH ASSUMPTIONS FOR US ONLY ARE A 7.5,
B 5.5)

	A	B
RECOVERY EFFECTS ON		
TRADE BALANCE	11	6.75
COMMODITY PRICE EFFECTS	1.25	.5
CHANGES IN NET OIL IMPORTS	3.5	2.5
CHANGES IN EXPORTS TO OPEC	4.5	4.5
RECOVERY EFFECT ON INVISIBLES	-.5	-.5
TOTAL CHANGE	9.5	4.75

14. IN SECTION ON INFLATION RATES AND EXCHANGE RATES
(REF B), SECRETARIAT RAISES FOLLOWING TWO BROAD QUESTIONS
FOR CONSIDERATION BY WORKING PARTY:
BEGIN QUOTE:

(I) LOOKING AT THE EXTREME CASES, THE UNITED KINGDOM
AND GERMANY, AND LOOKING AHEAD OVER A NUMBER OF
YEARS, DOES IT SEEM LIKELY THAT THE STRUCTURAL ADJUST-
MENTS REQUIRED WILL PROCEED FAST ENOUGH TO OVERCOME THE
FORCES AT PRESENT MAKING FOR SELF-PERPETUATING
DISEQUILIBRIUM?

(II) LOOKING AT OTHER COUNTRIES, IS THERE A DANGER
THAT SOME OF THEM MAY ALSO FIND THEMSELVES SETTLING
INTO A VICIOUS OR VIRTUOUS CIRCLE LINKING HIGH RATES
OF INFLATION AND CURRENCY DEPRECIATION, OR VICE VERSA?
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END QUOTE
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: MEETING AGENDA, DOCUMENTS, ECONOMIC GROWTH, ECONOMIC PROGRAMS, BALANCE OF PAYMENTS
Control Number: n/a
Copy: SINGLE
Draft Date: 30 OCT 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CunninFX
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975OECDP28232
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750377-0148
From: OECD PARIS
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t1975105/aaaaaenu.tel
Line Count: 372
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: CunninFX
Review Comment: n/a
Review Content Flags:
Review Date: 23 MAY 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <23 MAY 2003 by CunninFX>; APPROVED <09 OCT 2003 by CunninFX>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: WORKING PARTY 3 PAPER ON FUTURE PATTERN OF CURRENT BALANCES
TAGS: EFIN, ECON, OECD
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006